

What Lenders to Gaming Companies Should Know About Nevada Gaming Law

OVERVIEW

Perhaps more than any other state, Nevada understands the importance of the availability of credit to its licensed casinos and gaming manufacturers. The Nevada Gaming Control Act, which forms the basis for all gaming regulation, specifically states that the state's public policy is "that the rights of the creditors of licensees are protected." Therefore, not surprisingly, Nevada's gaming regulatory scheme is quite friendly to creditors. Nevertheless, the accommodation must yield to the broader policies that gaming is strictly controlled to assure that it is honestly conducted and free from criminal and corruptive elements. Some keys to strict regulation are licensing and related approvals of those involved in the gaming industry, and the reporting, review and approval of significant transactions. A result is that lenders to gaming companies must understand the unique regulatory requirements brought to bear as the result of strict regulation.

This booklet is divided into two parts. The first part describes the regulatory requirements that apply before a loan can be made to a Nevada gaming company. These relatively minor regulations involve an understanding that a lender to a Nevada gaming company subjects itself to the jurisdiction of the Nevada gaming regulators including the possibility of having to undergo a suitability review, that loans to Nevada gaming companies must be reported, and in certain circumstance the issuance or pledges of securities require prior approval.

The second part of the booklet deals with the regulatory aspects of loans that go bad. As with most commercial loans, lenders to gaming companies expect that the debtors will repay the borrowed monies according to terms of the credit facilities. In most every case, this is the course of events.

In cases of the exceptions to the rule, however, lenders need to be aware of and make provisions for compliance with gaming laws that may apply to the debtor and its assets. Some lenders may have already experienced gaming regulation because some types of security require prior gaming regulatory approval to be effective (e.g., pledges of stock of privately owned companies). These approvals typically are obtained before a transaction closes and the creditor-debtor relationship begins.

For other lenders, however, the first experience that they may have with gaming regulation involves regulatory compliance relevant to managing defaulting loans. Here, gaming regulation often creates a unique situation that impacts a lender's ability to foreclose on the collateral. In most industries, a lender's right may include assumption of the business operations of the defaulting debtor. In the gaming industry, however, a lender generally cannot assume control of a gaming business without prior gaming regulatory approval. Moreover, certain gaming assets like slot machines often cannot be transferred without prior gaming regulatory approvals.

Sophisticated debtors may attempt to use the gaming regulatory structure to their advantage against less sophisticated lenders. For example, a debtor can use a lender's

inability to take over gaming operations without the appropriate licenses as leverage to renegotiate the terms of a loan transaction after a debtor default. Lenders may be disadvantaged because the only quick way to gain control of a gaming debtor's business would be to cease gaming operations, which would adversely impact the value of the collateral.

Lender's rights of foreclosure are rarely exercised outside of a bankruptcy action. Historical precedence in the gaming industry demonstrates that defaults on loan obligations by gaming companies end up in bankruptcy court. Of course, exceptions exist. Recently, the senior lender to Progressive Games, a publicly traded gaming device manufacturer, had a priority secured position in that company's assets. The senior lender noticed the assets for public sale but was able to consummate a private sale of most assets to a junior lender.

Foreclosures Generally

In general, Nevada allows a secured party to foreclose on real property, gaming devices, proceeds from the operation of casino games and personal property gaming collateral, including stocks, bonds and other securities issued by a gaming company or a holding company. Except for stock of a gaming company and gaming devices, no foreclosure involves any regulatory approvals. For example, a secured party may foreclose on real property without prior approval, subject to general foreclosure law procedures.

A creditor must, however, obtain prior approval of the Nevada Gaming Commission ("Commission") before enforcing a security interest in the stock of a Nevada gaming company. In many cases, the purchaser of that stock also must obtain a Nevada gaming license.

Bankruptcy Restructures

More often than not the relationship between lenders and defaulting debtors in the gaming industry results in a bankruptcy restructure that allows the business to remain open, employees to remain employed, and the debtor and its creditors to explore ways by which to maximize the value of the bankrupt company and the return to creditors. In some instances, the parties may agree to reorganize the company outside of bankruptcy but must file a bankruptcy petition to achieve the agreement because of other creditors.

Other common ways for a gaming bankruptcy exist. In some cases, the debtor may voluntarily file without having reached an agreement with any of its lenders. In others, a group of creditors may cause an involuntary filing. Either way, the bankruptcy becomes a venue for determining how the debtor will be restructured and what happens to its assets.

Within the confines of a bankruptcy action, rights of foreclosure may ultimately come into play and be exercised under the umbrella of the bankruptcy court. The gaming regulatory agencies and the bankruptcy courts work in tandem to administrate gaming

bankruptcies. They aim to achieve the best interests of the bankruptcy estate in a manner consistent with gaming laws and regulations.

Restructuring Alternatives

In seeking the most effective restructuring transaction to protect asset value, there are three types of bankruptcies used for gaming companies, who then are categorized as debtors:

- 1- Chapter 11 reorganization with a debtor that generates enough cash flow to continue operations and/or has significant debtor-in-possession financing to justify the bankruptcy court allowing the debtor to continue to operate during the bankruptcy and allowing the debtor to offer a plan of reorganization to its creditors and to the court. Examples of this type of bankruptcy were: Stratosphere Casino and Hotel, Fitzgerald's Gaming Corporation and the Aladdin Casino and Hotel. In each instance, the gaming companies were able to stay open and continue operations while a reorganization plan worked its way through the bankruptcy court.
- 2- Chapter 11 reorganization with a debtor that either does not generate enough cash flow to continue operations or does not have adequate debtor-in-possession financing to finance the bankruptcy long enough to go through a plan of reorganization process. In this instance, the bankruptcy court may order a Section 363 sale of the debtor's assets (also called a "hammer sale"), which results in the property being marketed for sale. In such an instance, a stalking horse bidder will be solicited and an auction will subsequently take place. The equity owners of the debtor are able to participate in the auction and bid for the assets. Examples of this type of bankruptcy are: The Resort at Summerlin and Stateline Casino. In both of these instances, the gaming companies were able to stay open with the agreement that a sale process would be immediately initiated.
- 3- Chapter 7 liquidation with a debtor that does not generate positive cash flow and who does not have the ability to get debtor-in-possession financing to continue operations. In this type of situation, the bankruptcy court and the gaming regulators work together to appoint a trustee to take over operations and institute efforts to liquidate or sell the assets. Examples of this type of bankruptcy are: The Maxim Hotel and Casino and Fitzgerald's Reno (when it was the sole remaining asset of Fitzgerald's Gaming Corporation that couldn't be sold when the buyer declined to purchase that property along with the other three).

Regardless of the type of gaming bankruptcy, once a bankruptcy is filed, the fiduciary duty over gaming operations shifts from the equity owners of the company to the bankruptcy estate itself (and more specifically to all of the creditors). The goal being that the gaming company's operations continue so as to maximize revenues and make it more likely that all creditor constituency groups can achieve the maximum recovery.

Often, the prior owner's equity is wiped out as it is last in priority (i.e. all creditors would need to be paid in full to allow any payment to the equity holders).

Specific to a Chapter 11 bankruptcy case, the debtor will propose a plan of reorganization based on its negotiations with creditors. Several restructuring alternatives are available to gaming companies seeking protection under Chapter 11 of the Bankruptcy Code. Among the alternatives are (i) refinancing outstanding debt, (ii) converting debt to equity, or (iii) selling assets pursuant to Section 363 of the Bankruptcy Code or a plan of reorganization. Most plans of reorganization will include a combination of these restructuring alternatives as detailed more fully below.

Refinancing in a Chapter 11 Bankruptcy Case

In many cases the easiest restructuring alternative available to a gaming debtor is to refinance its existing debt. As with the initial debt transaction itself, when a gaming debtor proposes to refinance existing debt, gaming regulators retain the discretion to require the both new and existing lenders to undergo suitability investigations. This regulatory discretion, however, is rarely exercised so long as the lenders are bona fide banking institutions. In addition, the refinancing of debt may require prior regulatory approval. The debtor's ability to approve the plan of reorganization will likely be dependent on the lender and/or transaction being approved by the gaming authorities.

Debt for Equity in a Chapter 11 Bankruptcy Case

An equity swap is another restructuring option available to a gaming debtor. To effectuate the equity swap, a significant amount of the debtor's creditors must accept the debtor's plan of reorganization (at least two-thirds in amount and a majority in number of those creditors voting in the class whose claims will be subject to conversion into equity of the reorganized). An equity swap will likely create gaming licensing issues for the lenders, the result of which will vary depending upon the nature of the entity in bankruptcy (public or private) and the jurisdictions in which that company does business. Likewise, a creditor may want to convert some of their debt into equity, either through a plan of reorganization or as part of a bid in a Section 363 sale, pursuant to the U.S. Bankruptcy Code. These issues arise because equity holders that reach a certain percentage of the equity interest in a gaming company, holding company or parent company may face mandatory licensing. This type of debt into equity swap occurred in the Elsinore bankruptcy in the 1990s, relating to the Four Queens property in downtown Las Vegas.

Asset Sales in a Chapter 11 Bankruptcy Case

A third restructuring option is for the debtor to sell its assets to a third party. Any sale of assets by the gaming debtor is subject to both bankruptcy court and gaming regulatory approval. An asset sale may be very beneficial to a creditor who is unwilling or unable to undergo the licensing or suitability scrutiny required in an equity swap. In the sale process, only the buyer and certain related entities and individuals will undergo such scrutiny. However, potential downsides exist for creditors in an asset sale including that

it is not guaranteed to yield the best recovery for creditors. Additionally, no assurances exist that the buyer will be able to timely obtain the required licenses.

Exemptions to Mandatory Licensing

Any reorganization or sale would need to go to the applicable gaming regulatory agencies for a regulatory review and possible licensing after the bankruptcy court rules. The gaming license investigations that may be necessary can range from a full-blown new gaming investigation of a company that has never been licensed before in a jurisdiction (which would take the most time) to an updated investigation of a company that is already licensed in a jurisdiction. Of course, the more jurisdictions in which a gaming company does business, the more gaming regulatory agencies that come into play.

In some circumstances, creditors may be able to afford themselves of certain licensing exemptions (i.e. public company status of the bankrupt entity, institutional investor status for members of the lending group, or non-voting stock). If the creditor wants to assume an operational role with members of its constituency group serving as officers, directors or key employees, then at a minimum these individuals would need to be identified and go through the licensing process. Many large institutions and other creditors may not want their organizations or management to be subject to the intense regulatory review. Until a creditor is found to be suitable by the gaming authorities, it cannot receive as distribution an equity interest in the reorganized debtor under the plan of reorganization.

Depending upon the circumstances of the bankrupt property, applying for and obtaining emergency participation to be involved in operations may be available to a buyer that has filed a gaming application. This happened in the Resort at Summerlin bankruptcy when, at the time of the auction disposition, the debtor did not have a high level executive with gaming experience. Since the buyer's gaming operator had previously obtained a Nevada gaming license and had significant gaming operational experience, the buyer received an approval for emergency participation.

For a comprehensive review of what a gaming licensing investigation entails and who must be licensed, please see our Gaming Practice Group's Guide on Obtaining a Non-restricted Gaming License in Nevada.¹

REGULATORY OVERVIEW

Before discussing the regulatory requirements applicable to creditors, the reader needs to understand who regulates the Nevada gaming industry. Nevada has a two-tiered regulatory system.

State Gaming Control Board

¹ <http://www.lrlaw.com/files/Uploads/Documents/Obtaining%20Nonrestricted%20Gaming%20License.pdf>

The State Gaming Control Board (“Board”) administers the Gaming Control Act and its corresponding regulations adopted by the Nevada Gaming Commission.

Key Points - State Gaming Control Board

- Three members appointed by the Governor.
- Full-time agency.
- Has seven divisions including Investigations and Corporate Securities.
- Investigations Division investigates all gaming license and key employee applicants.
- Corporate Securities Division investigates and processes applications filed by publicly traded corporations.

The Board investigates the qualifications of each applicant before the Commission issues a license or grants any of the other required approvals. After completing an investigation, the Board recommends the Commission deny, limit, condition, restrict, or approve any license, registration, finding of suitability or other approval.

Nevada Gaming Commission

The second agency is the Nevada Gaming Commission. It is a part-time administrative body that has the final authority in deciding an applicant’s suitability and issuing a gaming license. As the state’s final authority, the Commission may accept, deny or modify the recommendation of the Board on a license application.

Other gaming regulatory agencies in the United States generally do not have a two-tiered system, but rather have a staff that makes a recommendation to a Commission in a single meeting. Another consideration is that other state gaming regulatory agencies may have different requirements than Nevada. This should be understood in multi-jurisdictional gaming bankruptcy.

LENDER CONSIDERATIONS BEFORE MAKING A LOAN

Licensing of Lenders

Normally, creditors including lenders do not have to be licensed. Nevada law recognizes that a creditor may use its position to exert influence over the conduct of a gaming company. The loans, while being critical for a gaming company’s survival, can result in the foreclosure of a gaming company. Although such circumstances are rare, it nevertheless puts substantial control over a gaming operation into the hands of unlicensed creditors. Therefore, the Commission requires licensure if the Commission feels a creditor has the power to exercise significant authority over the gaming

company² or if it would serve the public interest.³ In such cases, the Commission will notify the gaming company. The creditor will then have 30 days to apply for a license.⁴ The gaming company must assure that the creditor files the proper application in a timely manner.⁵

The Board often requires a finding of suitability when the lender is not an established commercial lender. There are four major types of commercial lenders:

- Banks or savings and loans regulated by the U.S. Comptroller of Currency or similar governmental agency;
- National insurance companies;
- Federally regulated pension or retirement funds; and
- Foreign regulated banking institutions that permit gaming officials access to information and the lenders must prove funds come from general deposits and not specific depositors.

Reports of Loans

A gaming company cannot borrow money for a gaming operation without complying with the regulations.⁶ A gaming company must report certain loans, credit extensions, guarantees and other security provisions made to or accepted on the gaming company's behalf within 30 days after the end of the quarter in which the transaction is consummated.⁷ The regulation governing this reporting divides the transactions into two categories, each with different dollar thresholds that trigger reporting depending on the gross revenue of the reporting gaming company. These reporting requirements provide the Board with information on the involvement of creditors, lenders, guarantors and

² Nev. Rev. Stat. § 463.165.

³ Nev. Rev. Stat. § 463.530.

⁴ Nev. Rev. Stat. § 463.165(2).

⁵ See e.g., NGC Reg. 15.530-533.

⁶ Nev. Rev. Stat. § 463.300.

⁷ NGC Reg. 8.130. Certain other transactions do not have to be reported. These include:

- Draws against a previously reported extension of credit.
- Goods or services that are exchanged for other goods or services of an affiliate of the licensee.
- Short-term cash loans.
- Loans and other financing activities that were reviewed during an investigation that resulted in Board or Commission action.
- Financing for gaming devices installed and used during a trial period.
- Funds received in satisfaction of accounts or notes receivable.
- Purchases or leases of gaming devices where the seller or lessor and the financier is a licensed manufacturer or distributor.
- Cash, property, credit, services, guaranty, benefit or any form of security loaned to the licensee by a licensed affiliate other than a stockholder, partner or proprietor of the licensed operation, licensed subsidiary or registered parent of the licensee.
- Assessments for property taxes or other taxes
- Payments of gaming winnings over time to patrons.
- Deposits or payments for conventions or similar events.
- Leases, including leaseback transactions and capital leases, where the lease term, including any extensions or renewals, does not exceed 90 days.
- Financing activity that has been approved by the Board Chairman.

holders of indebtedness in the gaming industry, such as names and addresses of all parties to the transaction, the amount and source of the funds, property or credit received or applied, the nature and amount of security provided by or on behalf of the licensee, and the purpose of the transaction. If a party to any transaction reportable pursuant to this regulation is a person other than the reporting licensee or a financial institution or related subsidiary, or a publicly traded company, a supplemental filing must accompany the report. This filing must include that party's federal tax identification number or social security number and date of birth, banking references, source of funds, and any additional information the Board may require.

Approval of Pledges or Other Restrictions on the Transfer of Stock

A privately-held corporate licensee and its licensed shareholders must obtain prior approval for a variety of other actions. The most common approvals sought are for:

- the issuance or transfer of stock in a licensed company or registered holding or intermediary company for any reason, including back to the corporation itself for cancellation, or pursuant to a stock split or stock dividend;
- the pledge of stock to secure financing; and
- the granting of an option to purchase such stock.⁸

A second type of stock pledge, called a negative pledge, also requires prior approval.⁹ A negative pledge is an agreement by the owner of stock not to sell, transfer or pledge the stock, as well as an agreement not to encumber such stock. A person lending funds to the owner of stock may require a negative pledge to assure the debtor has assets from which to pay back the loan.

Issuance of Debt Securities

Before a gaming company that is approved as a corporate licensee can issue any debt security, it must secure prior approval from the Commission.¹⁰ A security includes bonds, debentures, and other interests or instruments.¹¹ A debenture is a bond issued by the debtor as evidence of the debt owed. Debentures entitle the holder to certain rights, including the payment of interest.

A registered publicly-traded corporation may make a public offering of debt securities with specific approval of the Commission or under the general approval of a shelf offering. Persons holding a debt security, like any other beneficial owners or holders of indebtedness, may be subject to a finding of suitability.

Some debentures or bonds are convertible into stock. In other words, a convertible debenture holder can change his status from a debt holder to an equity investor. Before

⁸ Nev. Rev. Stat. §§ 463.510(1) and .540(1).

⁹ NGC Regs. 15.510.1-4 and .585.7-3.

¹⁰ Nev. Rev. Stat. § 463.510; NGC Reg. 15.540.1-2; the licensee also must report the issuance of debentures as a loan under NGC Reg. 8.130.

¹¹ NGC Reg. 15.482-8.

conversion, the convertible debenture holders would be subject to discretionary licensing. Since the holders become equity investors upon conversion, they are subject to the same rules as other shareholders. This includes mandatory licensing if they acquire more than 10% of any class of voting stock or acquire control of the publicly-traded corporation. It should be noted that for multi-jurisdictional gaming companies, the threshold for mandatory licensing is 5% in some jurisdictions outside of Nevada.

A privately-held corporation, whether a licensee or a holding or intermediary company, may not issue or transfer any security, debt or equity, including options to purchase such securities, without complying with the gaming laws. A privately-held holding or intermediary company must receive prior approval to issue or transfer any security.¹² However, any debt security that is also an evidence of indebtedness reported to the Board under NGC Reg. 8.130 is not a "security" and, accordingly, no prior approval is necessary.¹³

A corporate licensee must file a report of the proposed transfer or issuance with the Board and Commission. The Commission has then 90 days to approve or deny the request. If the Commission denies the request, the gaming company may not issue or transfer the security.¹⁴ The issuance or transfer may require separate approval under Commission Regulation 8 governing the transfer of interest among licensees¹⁵ and to an unrelated third-party to the licensee.¹⁶

These requirements have been interpreted by the Board and Commission to apply as well to stock dividends, stock splits and stock cancellations of corporate licensees and privately-held holding and intermediary companies.

A corporate officer must sign the application for approval of the issuance or transfer of securities. An application must contain much of the same information that a company registering with the Board must provide, together with all information about the current transaction.¹⁷

REGULATORY ASPECTS OF LOANS THAT GO BAD

Foreclosures

As noted earlier, Nevada generally allows a secured party to foreclose on any of the assets of a gaming company except for the stock of a gaming licensee and gaming devices without any regulatory approvals.¹⁸

Foreclosure of the Stock of Gaming Company (Directly or Indirectly)

In Public Companies

¹² NGC Reg. 15.585.7-1.

¹³ NGC Reg. 15.482-8.

¹⁴ Nev. Rev. Stat. § 463.540.

¹⁵ NGC Regs. 8.010(4), 8.020, and 15.540.1-2.

¹⁶ NGC Regs. 8.010(4), 8.030, and 15.540.1-2.

¹⁷ NGC Reg. 15.540.1-2.

¹⁸ NGC Reg. 8A.020(2).

No approval is needed to enforce a security interest in the stock of a publicly-traded corporation unless the secured party would acquire control of the company or more than 10% of any class of voting security.¹⁹

In Private Gaming Companies Including Those Owned by Public Companies

Stock of a gaming company is considered personal property gaming collateral.²⁰ With regard to personal property gaming collateral, a secured party must obtain prior Commission approval before enforcing a security interest.²¹

A secured party shall apply for approval to enforce a security interest in such collateral using such form as the Chairman may prescribe.²² The application must include: a complete schedule and description of the gaming collateral; copies of the security agreement and documents evidencing the obligation secured; a statement by the applicant describing the act of default; and a copy of the notice of default.²³

The Board will then conduct an investigation by reviewing pertinent documents; analyzing the impact on the gaming company by approving the enforcement of the security interest, including whether the enforcement will disturb or curtail operations; reviewing whether the security interest, when granted, complies with the Nevada law and gaming regulations; and investigating any other matter the Board considers relevant.²⁴

The Commission shall not approve the enforcement of such security interest in personal property if such enforcement will result in any person becoming subject to mandatory licensing, registration, or finding of suitability, unless all persons have been licensed, registered, or found suitable by the Commission, as applicable.²⁵

In the case where the pledged security is less than majority control of the gaming company, the regulations allow for waiver of the licensing requirements, but prevent the secured party from exercising any voting rights or control over the gaming company. The Commission may grant a temporary or permanent waiver of the requirement of prior licensing, registration, or finding of suitability, or may grant delayed licensing, registration, or finding of suitability, upon written request by the secured party and recommendation of the Board, if the Commission makes a written finding that such waiver or delayed licensing, registration, or finding of suitability is consistent with state policy set forth in the Act.²⁶ The Chairman may permit the licensee or holding company to register or record the securities in its books or records in the name of the secured party, but only if the secured party has filed an application for approval to enforce a

¹⁹ NGC Reg. 8A.010(4)(c).

²⁰ NGC Reg. 8A.040(1). ("Personal property gaming collateral including stocks, bonds and other securities issued by a gaming license or holding company.").

²¹ NGC Reg. 8A.040(1).

²² NGC Reg. 8A.030(1).

²³ NGC Reg. 8A.030.

²⁴ NGC Reg. 8A.030(2).

²⁵ NGC Reg. 8A.040(1).

²⁶ NGC Reg. 8A.040(1).

security interest.²⁷ The secured party, however, may not exercise any voting rights or other control over the licensee or holding company, and that all dividends payable or other beneficial interest in the securities be held in escrow, pending final action on the application to enforce.²⁸

Notwithstanding these provisions, approval is not required under this regulation to enforce a security interest in a security issued by a holding company, or by a corporation, general partnership, or limited partnership licensee, if the gaming operation has ceased and the operating license has been surrendered to the Board prior to the enforcement of such security interest.²⁹

In the absence of obtaining approval, the secured party has several options:

- The secured party obtains a license and assumes direct control of the gaming company. This is typically not an option because of the time, cost and complexity of licensing financial institutions.
- If the secured party is not licensed, registered, or found suitable by the Commission as applicable, the Commission may, upon its own initiative or that of the secured party, petition the district court for appointment of a Supervisor to operate the gaming company after the license is surrendered to ensure the continuation of the gaming operation.³⁰
- The secured party may bring in a new licensed operator pursuant to an operating agreement or lease agreement.
- The secured party may leave the existing licensee in place until a new buyer or lessee is found.

Foreclosure of Gaming Equipment

Security interests in gaming devices and proceeds from the operation of the casino games also may be foreclosed without prior approval.³¹ There are, nonetheless, limitations with regard to the disposition of those gaming devices, as “it is unlawful for any person, either as owner, lessee or employee, whether for hire or not, to operate, carry on, conduct or maintain any form of manufacture, selling or distribution of any gaming device”³²

However, “[i]n cases of ... foreclosure of a lien by a bank or other person holding a security interest for which gaming devices are security in whole or in part for the lien, the Board may authorize the disposition of the gaming devices without requiring a distributor’s license.”³³ Therefore, a secured party must go through the administrative

²⁷ NGC Reg. 8A.040(3).

²⁸ NGC Reg. 8A.040(3).

²⁹ NGC Reg. 8A.020(3).

³⁰ See NGC Reg. 8A.040(2) and Nev. Rev. Stat. § 463B.080.

³¹ See act of June 18, 1991, ch. 390, 1991 Nev. Rev. Stat. § 1011.

³² Nev. Rev. Stat. § 463.650(3).

³³ Nev. Rev. Stat. § 463.650(3).

process by applying to the Board for administrative approval to dispose of the gaming devices and, upon approval, will then need to sell to someone who holds a manufacturer/distributor license.

Appointment of a Supervisor

Nevada law provides that if the closure of a gaming company occurs due to a surrender, lapse, revocation or suspension of its license, “placing the management and control of a gaming company under a competent supervisory official may ensure the proper regulation of the gaming company while maintaining its value for its creditors and investors, protecting the interests of other persons, avoiding any disruption of the economy of the community in which it is located, and promoting the general welfare of the state.”³⁴

Generally

The power to initiate the placement of a competent supervisory official (the “Supervisor”) is vested in the Commission. This statutory authority is very rarely used.

In 1982, Boyd Gaming Corporation was appointed as a Supervisor at the Stardust after gaming regulators raided the casino amongst allegations of skimming by organized crime. Supervisors also were placed in casinos after disciplinary action against the owners at the Silver Spur in Henderson, Nevada in 1988.

Two appointments of Supervisors resulted from the financial distress of properties. They were the Station House Casino in Tonopah and Fitzgerald’s Reno. The circumstances were different. In the case of the Station House, the gaming licensee defaulted under a loan secured by the real estate. The lender foreclosed on the real estate and the property was set to close except for the appointment of a receiver. In the case involving Fitzgerald’s Reno, the bond holders of the corporation foreclosed on the stock of the corporation but could not operate the casino because they did not have a license. The bankruptcy court appointed the Supervisor to operate the casino for the benefit of the unlicensed corporation until such time as the property could be sold.

When the Harrah’s Entertainment-Caesars Entertainment merger was being considered, the Federal Trade Commission (“FTC”) determined that the combined company would have too many casinos in Northern Nevada, so it was agreed that Caesars Tahoe would be sold. Caesars Tahoe was to be sold to a gaming company that also had a significant Northern Nevada presence, so it also needed FTC approval. When it looked like Caesars Tahoe might not receive clearance from the FTC in time to be sold, the Board and the Commission entertained the concept of appointing a Supervisor for that property in order to allow the Harrah’s-Caesars transaction to close. This even got to a point of being placed on an agenda, but the FTC ruled in time for this action to have not been necessary after all.

³⁴ Nev. Rev. Stat. § 463B.050.

A Supervisor also was voluntarily placed on two occasions relating to shareholder disputes in Silver State Gaming.

The Appointment Process

Circumstances When a Supervisor May Be Appointed

If the license of any person whose license is essential to the operation of the gaming establishment is either:

- revoked or suspended by the Commission;
- lapses; or
- surrendered because the gaming establishment or the ownership thereof has been transferred to a secured party who does not possess the licenses necessary to operate the gaming establishment.

Nevada Gaming Commission Initiates the Process of Appointment by Petitioning the Court

The Commission, in their own discretion, may petition the district court for the county in which the gaming establishment is located (the “Court”) for the appointment of a Supervisor to manage the gaming establishment. This is an ex parte procedure. This is the only method for appointment of a Supervisor.

The Petition is actually the second step of the process and results from prior administrative proceedings. As a practical matter, the party seeking the appointment of the Supervisor is typically either the lender/bondholder of the gaming establishment that wants to protect the value of the ongoing business or the Board that wants to prevent the displacement of gaming employees. It is initiated because without the appointment of a Supervisor, the property will be closed and, thus, impact lenders, creditors and gaming employees. The lender/bondholder would seek an audience with both the chairman of the Board and Commission to initiate the process. The lender/bondholder would set out the reasons why the appointment of the Supervisor would meet the criteria of the gaming laws and regulations as described below. If the request has merit, the Commission will set a hearing. The Board would be tasked to review the circumstances and provide input to the Commission.

Timing of the Administrative Hearing Where the Commission Decides Whether to Seek a Supervisor

The Commission shall hold a hearing within 15 days after the suspension of a license and will provide public notice of the hearing.

Standstill During Process of Appointing a Receiver

During the pendency of any proceeding before the Commission that may result in the appointment of a Supervisor or during the period of supervision, neither the existing gaming licensee nor any other person may:

- sell, lease or otherwise convey for less than full market value or to hypothecate any property of a gaming company; or
- remove or secrete from the Commission or the Supervisor of a gaming establishment any property, money, books or records of the gaming establishment, including evidences of debts owed to it.

A person who violates any provision of Subsection 1 is guilty of a Category D felony and shall be punished as provided in Nev. Rev. Stat. § 193.130.”³⁵

Hearing Procedures

The hearing is a public hearing but does not follow any formal procedures or rules of evidence. The Commission will notify the existing gaming licensee of the meeting and “afford the licensee the opportunity to be heard concerning the appointment.”³⁶

Any person who suffers or is likely to suffer direct financial injury as the result of an act or omission of a Supervisor may file an objection with the Commission to the suitability of the Supervisor.³⁷

The criteria used by the Commission in deciding whether to seek a Supervisor include:

- the nature of the violation which resulted in the revocation, suspension, surrender or lapse;
- the ability and actions taken, if any, for a removal by licensees in good standing of persons who committed the violation;
- the involvement during a proposed supervisorship in any operation of the gaming establishment of persons whose licenses were revoked, suspended, surrendered or lapsed;
- the economic impact of closure of the gaming operations upon the community in which the gaming establishment is located;
- the economic impact of closure of the gaming operations upon the State of Nevada;
- the prior efforts, if any, to sell the gaming establishment;
- the involvement, if any, of undisclosed interests in the gaming establishment;
- the presence, if any, of a publicly traded holding company and the public trading that would occur during a supervisorship;
- the current status of all fees and taxes applicable to the operation;
- the adequacy of existing financing for the operation, if continued, and the suitability of the source of such financing;

³⁵ Nev. Rev. Stat. § 463B.280.

³⁶ Nev. Rev. Stat § 463B.075.

³⁷ They may also petition the Court that made the appointment for an accounting or for a review of the Supervisor’s qualifications or performance.

- the impact upon public confidence and trust that gaming operations in Nevada are conducted honestly, competitively and free from criminal and corruptive elements;
- the ownership of the gaming establishment premises or an interest therein by persons other than the offending, surrendering or lapsed licensee;
- any other matter material to a full and complete consideration of the particular circumstances presented; and
- the availability of two or more persons qualified and willing to assume the position of Supervisor for the gaming establishment in question, unless, in the opinion of the Commission, only one person is available who is qualified to serve, in which case the Commission may name only that person.³⁸

Qualifications for a Supervisor

A candidate for Supervisor must be a person:

- of good character, honesty and integrity;
- whose prior activities, criminal record, if any, reputation, habits and associations do not pose a threat to the public interest of this State or to the effective regulation and control of gaming or charitable lotteries, or create or enhance the dangers of unsuitable, unfair or illegal practices, methods and activities in the conduct of gaming or charitable lotteries or in the carrying on of the business and financial arrangements incidental thereto; and
- who has adequate business probity, competence and experience, in gaming or generally.

Court Action on a Petition

If after the administrative proceedings, the Commission decides to seek appointment of a Supervisor, the State Attorney General's Office will prepare and submit an ex parte petition to the court in the county where the property is located. The petition contains the names of two or more persons who the Commission believes are suitable and qualified to manage a gaming establishment and are available for appointment as a Supervisor unless, in the opinion of the Commission, only one person is available who is qualified to serve, in which case the Commission may name only that person."³⁹ The Commission also may petition for the appointment of more than a single individual, such as a management team, association or company, where such an appointment would better meet the circumstances and the needs of the gaming establishment.⁴⁰ If, in the opinion of the Commission, only one person is available who is qualified to serve as the Supervisor, the Commission may name only that person. As a practical matter, the petition will probably only have a single person named. Upon the receipt of the petition,

³⁸ NGC Reg. 17.030(2).

³⁹ Nev. Rev. Stat. § 463B.080(4); NGC Reg. 17.040(1).

⁴⁰ NGC Reg. 17.040(3).

the Court shall appoint the person(s) named in the petition as the Supervisor(s) of the gaming establishment.

Compensation of Supervisor

The Court, which appointed the Supervisor, shall allow for reasonable compensation, out of the revenue of the gaming establishment, for the services, costs and expenses of the Supervisor and for any other persons whom the Supervisor may engage to aid them in their duties.

Replacing a Supervisor

The Commission may, at any time after the appointment of a Supervisor, petition the Court for the removal of the Supervisor and the appointment of a new Supervisor or for the termination of the Supervision.

If at any time the court finds that a Supervisor is not qualified or available to serve as Supervisor, it shall request from the Commission the names of two or more persons who the Commission believes are suitable and qualified to manage a gaming establishment and are available to serve as a Supervisor unless, in the opinion of the Commission, only one person is available who is qualified to serve, in which case the Commission may name only that person.

Termination of the Supervisor

The appointment of a Supervisor terminates if any court of this state or of the United States overrules the Commission's decision to revoke or suspend the license for operation of the gaming establishment, or if the Commission's petition for termination is granted, except that the Supervisor shall transfer to the appropriate persons their respective interests in the gaming establishment.

The Commission also may seek termination if:

- license fees and taxes are not paid when due;
- the gaming establishment enters into voluntary or involuntary bankruptcy proceedings;
- the gaming establishment's debts exceed the value of its assets or the gaming establishment cannot meet its debts as they become due;
- a violation of the gaming laws or the regulations relating to the gaming establishment has occurred subsequent to the supervisorship;
- a former owner, his agent, employee or representative violated any statute or regulation relating directly or indirectly to gaming or the administration of the supervisorship, other than the violation, if any, which resulted in the revocation, suspension, surrender or lapse;
- the death, disability, or removal of the Supervisor;

- closure of gaming operations at the gaming establishment for any reason, regardless of fault; or
- any circumstances that renders continued operations under the supervisorship impractical or detrimental to the interests of the State of Nevada, or licensed gaming, or both.

No Impact on Creditor Rights

The appointment of the Supervisor does not affect the right of a creditor to commence or continue foreclosure or other proceedings to collect a secured or unsecured debt, and the appointment must not be treated as an event precipitating a default or acceleration under any note, lease, deed of trust or other extension of credit.

Duties and Powers of the Supervisor

The Supervisor is deemed to be a licensee of the gaming establishment under any license issued to operate the gaming establishment by a county, city or town, and may perform all acts that they are required or permitted to perform without approval or other action of the county, city or town.

Upon the appointment of a Supervisor, the right, title and interest of all persons in the gaming establishment are extinguished and automatically vest in the Supervisor, subject to any liens, claims and encumbrances thereon.

The Supervisor shall take “immediately into his possession all property of the gaming establishment, including its money, accounts, books, records and evidences of debts owed” and “continue the business of the gaming establishment.”⁴¹

Unless authorized by the court, (i) all the books and records relating to the operation of the gaming establishment and all evidences of debts owed to the gaming establishment must be kept and retained in the State of Nevada and (ii) all the money of the gaming establishment which is to be deposited with financial institutions must be kept in accounts in financial institutions located in the State of Nevada.

The Supervisor may:

- hire, discipline and dismiss employees of the gaming establishment, and fix the compensation of its employees;
- engage independent legal counsel and accountants;
- settle or compromise with any debtor or creditor of the gaming establishment;
- prosecute actions on behalf of or defend actions against the gaming establishment;
- enter into any contract or borrow money on behalf of the gaming establishment and pledge, mortgage or otherwise encumber its property as

⁴¹ Nev. Rev. Stat. § 463B.150.

security for the repayment of any loan, except that the power to borrow money or encumber property is limited by any provision of an existing document of credit;

- grant or renew leases of the property of the gaming establishment; or
- perform any other lawful acts on behalf of the gaming establishment which an owner is entitled to perform (this does not authorize the sale of the gaming establishment by the Supervisor).

Continuing Role of the Court in the Process

The court that appointed the Supervisor has jurisdiction over all of the powers and duties of the Supervisor in any proceeding relating to the exercise of those powers and duties.

To keep the court informed of the business at the gaming establishment, the Supervisor “shall file with the court which appointed him and the Commission reports on the administration of the gaming establishment in such form and at such intervals as the court may prescribe.”⁴² These reports may be made available for inspection by any creditor of the gaming establishment or person having a substantial interest in the gaming establishment.

Former Gaming Licensee’s Entitlement to Earnings

A Supervisor may not distribute earnings of the gaming establishment to the former licensed owners thereof, until deduction is made for:

- the costs of the supervisorship, including compensation and expenses incurred by the Supervisor and those engaged by him to aid in his duties, then due and owing;
- amounts deemed necessary by the Supervisor for continuing the operation of the gaming establishment, including, but not limited to, bankroll, salaries, and foreseeable operating expenses;
- amounts deemed necessary by the Supervisor to preserve the assets of the gaming establishment; and
- a reserve fund sufficient, in the determination of the Supervisor, to facilitate continued operation in light of pending civil litigation, disputed claims, contractual obligations, taxes, fees and any other contingency known to the Supervisor which may require payment by the gaming establishment.⁴³

Supervisor’s Role in the Sale of the Gaming Establishment

If any person who owned an interest in the gaming establishment at the date of appointment of a Supervisor secures a buyer for the gaming establishment before the

⁴² Nev. Rev. Stat § 463B 210(1).

⁴³ NGC Reg. 17.060.

time when the Supervisor must offer the property for sale and the persons who owned a majority of the interest in the gaming establishment on the date of the Supervisor's appointment approve the terms and conditions of the proposed sale, then the Supervisor shall petition the court that appointed him for approval of the sale. If the court grants approval, the Supervisor shall carry out the sale on the terms and conditions agreed to between the parties. In addition, the buyer must be licensed to operate a gaming establishment, and if the buyer is not licensed then they must obtain a license to operate the gaming establishment within six months after the time when the Supervisor offers the property for sale.

The Supervisor of the gaming establishment shall offer it for sale at any time before the time described in (i), (ii) or (iii) below, when requested in writing by the owners of a majority of the equity interest in the gaming establishment to initiate sale proceedings: (i) six months after refusal by the Commission to renew the license for the gaming establishment for failure of a licensee to fulfill a condition of their license; (ii) if no petition for judicial review is taken from the determination of the Commission to revoke or suspend the license, six months after the last date on which a petition for judicial review could have been filed; or (iii) if a petition for judicial review is taken, six months after exhaustion of any right of appeal in Nevada courts resulting in a final determination which upholds the revocation or suspension of the license, whichever date is later.

In addition, all known creditors and other persons designated by the court who are known to have had a legal ownership interest in the gaming establishment immediately prior to the appointment of the Supervisor must be notified of the proposed sale at least 30 days before the hearing on the petition for approval of the sale. Any person so notified may file with the court a statement of objections to the proposed sale, including all grounds for the objections no later than 10 days before the hearing. Upon completion of a sale of the gaming establishment, the appointment of the Supervisor terminates, except that they shall convey all his right, title and interest in the property of the gaming establishment to the buyer and shall pay the net proceeds of the sale to those persons who owned the property at the time he acquired it, or their successors or assignees, according to their respective interests.

Takeovers of Nevada Public Gaming Companies

A person cannot acquire control of a registered publicly-traded corporation without the prior approval of the Commission.⁴⁴

The regulations apply to obtaining control of a gaming company by ownership of equity securities, ownership of rights to acquire equity securities, statutory mergers, acquisition of assets, management and consulting agreements, or otherwise. "Control" means the

⁴⁴ NGC Reg. 16.200. There is no specific statutory authority for the Commission to have adopted this regulation. Therefore, authority rested upon the general grant to promulgate regulations consistent with the policy, objectives, and purposes of the Gaming Control Act as the Commission may deem desirable in the public interest. Nev. Rev. Stat. § 463.150(1) and .635(3).

direct or indirect possession of the power to direct or cause the direction of the management and policies of a person.⁴⁵

Applications for an acquisition of control should be filed using Board Form PTC-1 and PTC-200 and must contain full disclosure of all material facts relating to the transaction, including certain specified information.⁴⁶

The following considerations are relevant to all Commission Regulation 16 transactions, including public offerings and acquisitions of control:

- business history of the applicant, including its record of financial stability, integrity and the success of its operations;
- current business activities and interests of the applicant and those of its executive officers, promoters, financial backers or any other associates;
- current financial structure of the applicant and changes anticipated to occur to such financial structure because of the proposed action of the applicant;
- gaming-related goals and objectives of the applicant, including a description of the plans and strategy for achieving such goals and objectives;
- relationship between such goals and objectives and the requested approval;
- adequacy of the proposed financing or other contemplated action to achieve the announced goals and objectives;
- present and proposed compensation arrangement between the applicant and its directors, officers, principal employees, security holders, lenders or other financial backers or sources;
- equity investment, commitment or contribution of present or prospective directors, officers, principal employees, investors or other financial backers or sources;
- dealings and arrangements, prospective or not, between the applicant and any investment bankers, promoters, finders or financial sources;
- effect of the proposed action on existing and prospective security holders of the applicant, both before and after the intended action;
- whether the applicant has made complete disclosure of all material facts about the proposed action to the Board and the Commission and made provision for such disclosure to all prospective security holders;
- whether the proposed action is fair, just and equitable to investors; and
- whether the proposed public offering contains speculative securities.⁴⁷

⁴⁵ NGC Reg. 16.010(3).

⁴⁶ NGC Reg. 16.210.

⁴⁷ NGC Reg. 16.060.

The scope of the required information suggests that the main criteria of approval under Commission Regulation 16 are the financial and managerial impacts of the proposed takeover.

Uncertainty arises from not knowing whether the requested approvals will be granted. Some delay can be expected. The Commission, however, has stated it will use its best efforts to take final action upon an application for an acquisition of control by a person making a tender offer within 60 days of the date a complete application and the necessary fees are paid to the Board.⁴⁸

A person attempting to acquire control of a registered publicly-traded corporation may also be required to file simultaneously for a finding of suitability as a shareholder because he or she will be acquiring more than 10% of a class of its voting stock. This brings into play standards of business probity, financing and personal character.

Hostile Takeovers

The Nevada Legislature has declared that some corporate acquisitions opposed by management, repurchases of voting securities and corporate defense tactics affecting Nevada gaming licensees and registered publicly traded corporations affiliated with such state gaming licensees may be injurious to stable and productive gaming in Nevada.⁴⁹ The Commission has established a regulatory scheme to reduce the potentially adverse effects of such business practices upon Nevada's gaming industry and to further the state's policy with respect to these business practices.⁵⁰

LICENSING

For a comprehensive discussion on what a gaming license investigation entails, please see our Gaming Practice Group's Guide on Obtaining a Non-restricted Gaming License in Nevada. (<http://www.lrlaw.com/services/xprServiceDetailLR.aspx?xpST=ServiceDetail&service=30&op=Pubs>).

⁴⁸ NGC Reg. 16.050(2).

⁴⁹ Nev. Rev. Stat. § 463.621.

⁵⁰ Nev. Rev. Stat. § 463.622 and .623.